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UNITED STATES OF AMERICA

BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

Fact-Finding Investigation of Potential

Manipulation of Electric and Natural Gas Prices

Docket No. PA02-2-000

COMMENTS OF PLATTS ON FERC STAFF REPORT

I. Statement of interest

Platts, a division of The McGraw-Hill Companies, is the world's largest provider of energy information and research services. Its products range from real-time, Internet-based news and price assessment services to newsletters, market reports, databases, geospatial tools, magazines, conferences, research and consulting services, and energy financial services. Platts covers news and produces price assessments for the international oil, natural gas, electricity, coal, petrochemical, and metals markets.

On August 13, 2002, the Federal Energy Regulatory Commission issued an initial staff report in Docket No. PA02-2-000. In that investigation of potential Western market manipulation, Platts responded earlier this year to FERC staff's data requests on electric and natural gas price reporting. Staff's initial report makes a number of observations about price reporting by Platts and other publishers.

Platts is submitting these comments in response to certain findings in the staff report and to provide the commission with the clearest possible understanding of Platts' price reporting methods.

Platts takes seriously its role as a provider of independent, unbiased assessments, which are widely used to facilitate transparency in energy commodity markets worldwide. Its reputation depends largely on the perceived accuracy of its assessments, independence of its reporting and transparency of its methodologies. Of the three price reporting publications to be used in the refund methodology, two, *Gas Daily* and *Inside FERC's Gas Market Report*, are published by Platts. (*Gas Daily* became a Platts publication in September 2001 as a result of an acquisition, and effective July 1, 2002, the price surveys of the two publications were combined into a single survey.) The staff report also addresses electricity prices reported by Platts.

As noted in the staff report, Platts is refining its price reporting methodologies in an effort to make its assessments as accurate as possible, and welcomes staff's recognition of these efforts as "clearly a step in the right direction." Platts fully acknowledges the need to continuously update its methodologies to ensure that it is in step with market practices. But for the period in question, Platts is fully confident that its price assessments validly reflected prevailing market activity.

II. Market region vs. producing region prices

The staff report recommends that the commission adopt an alternative gas price calculation, which relies on Platts prices, in the California electricity price mitigation proceeding (EL00-95-045). In an August 13, 2002, order in that proceeding, the commission asked for comment on whether to adopt staff's recommendation and, if so, how to reflect the scarcity of gas supply in California during the refund period. Platts is not a party to that proceeding and takes no position on the question.

Platts reports daily gas prices at more than 100 locations in the U.S. and Canada because the gas markets do not always move in lock step. As staff points out, the basis differential between trading points "represents differences in fundamental supply and demand conditions between points . . . and is an important signal to both buyers and sellers." In recent months, for instance, prices in the Rocky Mountain producing basin have been unusually low and have not been highly correlated to prices at Henry Hub or in key markets such as California. Most analysts attribute the depressed prices to a lack of interstate pipeline takeaway capacity – providing a key price signal to companies interested in expanding that capacity.

It is precisely because Platts does report prices in so many regions that staff is able to choose as an alternative producing basin prices that did not spike as sharply as California market prices. If the rest of the U.S. gas market always moved uniformly with the Henry Hub price, there would be no need for Platts to report those basis differentials.

Experts such as the California Energy Commission attributed the California price spike to a number of factors that the staff report does not analyze: little excess interstate pipeline transportation capacity to California, exacerbated by the August 2000 rupture on El Paso Natural Gas; insufficient intrastate pipeline takeaway capacity; abnormally low levels of storage gas held by the California utilities heading into the winter of 2000-01; low hydropower availability; extremely cold weather in November 2000; and, according to some parties, actions taken by El Paso Merchant Energy and El Paso Natural Gas in managing pipeline capacity to California (the subject of rulings by an administrative law judge). Those factors were unique to the California market during the refund period, and use of supply basin prices will not capture their effects in the consuming market.

In sum, Platts' experience is that the North American gas market places great value on the reporting of prices as close to the point of production or consumption as possible, and Platts knows of no better ways to reflect scarcity.

III. Manipulation of the California market

The staff report repeatedly cites the possibility that the California energy market may have been manipulated during the winter of 2000-01. However, nowhere does it make an affirmative finding. Rather, the report offers a variety of conjectures that market participants may have deliberately reported inaccurate prices in an effort to influence publishers' price assessments, that data request responses from publishers "confirm that the published prices may be susceptible to manipulation," and that Enron, through EnronOnline, wash trades or both, may have manipulated the market.

Platts does not agree that its response confirmed that its assessments may have been susceptible to manipulation. The only example given in the staff report to support that conclusion cites electricity forward prices, not the gas prices that are the central focus of the report. As noted below, Platts believes staff may have misunderstood its explanation of how electricity forward prices are reported. Platts also does not agree with the conclusory nature of staff's report in the absence of specific facts – for example, the assertion that a "circularity in information sources" and "the lack of any external validation almost guarantee that errors would not be discovered and eliminated [by price reporting publications], and create an environment that facilitates, rather than discourages, manipulation and collusion." Platts believes that this claim is unfounded. Platts has in place rigorous systems, which it continually reviews, to detect and deter attempts to manipulate its price assessments.

Moreover, regardless of whether the California energy market was in fact manipulated, Platts maintains that its assessments accurately reflected the market. Even if, for example, Enron did attempt to manipulate the California market through its buy/sell postings on EOL, *that was the market.* Willing market participants did transactions at those prices, and Platts (and it believes other publishers) accurately reported that dealmaking. The extent of Enron's and EOL's influence in the market is an entirely separate question under investigation by staff and others, and Platts takes no position on the matter. Platts believes that any market is subject to attempted manipulation. However, that does not prevent accurate reporting on the market as it exists, and publishers such as Platts should not be placed in the position of having to prove a negative – that its prices were not manipulated because the market it was covering could not be manipulated.

IV. Generic characteristics of price reporting

The staff report cites "major problems with published price data." Those problems include the commission's inability to independently validate the price data and publishers' lack of formal verification procedures; incentives for market participants to manipulate reported prices; possible effects of wash trading; and EnronOnline's dominance as a source of price discovery.

In a number of instances throughout the report, staff fails to distinguish between a small subset of prices reported by Platts -- California prices for the locked-in refund period of October 2, 2000, through June 20, 2001 -- and the totality of price reporting by Platts and other publishers. Platts believes the report paints with too broad a brush in depicting the alleged deficiencies of price reporting.

Staff then proceeds to recommend use of an alternative that is based on Southwest and Canadian producing basin prices reported by *Gas Daily*. Those prices are reported using the same methodologies and techniques broadly criticized in the report. Platts does not understand how the staff reconciles these two positions. At a minimum, Platts asks the commission to explicitly clarify that any comments in the report about Platts' price reporting pertain only to California prices during the refund period. Generalized comments about Platts' reporting outside the market in question that aren't supported by reasoned analysis of the reliability of reported prices may reflect negatively on Platts and therefore be unfairly harmful to its reputation.

In stating that FERC is unable to independently validate the pricing data, the staff report acknowledges publishers' "legitimate" confidentiality concerns about revealing source data. Platts appreciates staff's recognition of these concerns and reminds the commission that there is legal precedent in the United States upholding the right of Platts journalists to not be compelled to disclose their sources.

The staff report says trade publications do not employ statistically valid sampling techniques and suggests, without any definition, that they should use "more statistically sound methods." Platts believes that participants in the U.S. gas and electricity markets view its price assessments as valid and reliable measures of actual market realities, rather than as some theoretical ideal. At the same time, Platts is always open to specific suggestions on ways to improve its surveys.

The staff report also suggests that "once the industry understands that the price data it has relied on previously" share the purported weaknesses identified by staff, firms such as Platts will improve their methods. Platts' methodologies are clearly stated and transparent, and it submits that the gas and electricity industries have long understood the techniques used in its price reporting. Prices reported by Platts for years have been subjected to the scrutiny of industry and government agencies – including FERC and the Minerals Management Service, which has based royalty payments to the federal government on Platts prices. The New York Mercantile Exchange, whose practices and safeguards are viewed favorably in the staff report, uses Platts' and another publisher's prices to clear gas basis swaps.

Likewise, staff is "troubled by the lack of reported formal verification or corroboration" that the price reporting publications say they employ. The report does not offer any specifics on what type of verification or corroboration techniques staff envisions. As elsewhere in the report, staff hypothesizes that "misreported prices could become part of the price formation process and adversely affect the true market price." Staff has provided no evidence that this occurred in California or elsewhere. Platts is aware that one marketer, Dynegy, has stated publicly it reported inaccurate data to trade publications, but Platts cannot assess whether there was any impact on reported prices because Dynegy has declined to provide any details.

Platts' assessment methodologies always have been public and Platts editors are available to explain its practices to any interested parties, as they have done both formally and informally in staff's investigation.

On the issue of forward electricity markets, the report says contracts in the forward market are not standardized and the reliability of forward assessments is "unknown" because "the reporting firms typically do not disclose the means by which they report these non-standard contracts." Platts would like to further clarify to the commission its reporting techniques.

As Platts attempted to explain in its response to FERC's data request earlier this year, there are a number of standard over-the-counter products traded daily in forward electricity markets. Platts assesses those standard products using the same reporting and market assessment methods that it and other publishers use in many other commodity trading markets. A detailed explanation of Platts' methodology for its daily forward electricity assessments is posted at www.platts.com, and a more detailed explanation of the methodology and the standard products that trade was provided to the staff in Platts' response to staff's data request.

V. Staff's two-part test for price reporting

In analyzing the California prices reported by Platts and other publishers, staff appears to create a two-part test for accuracy: 1) correlation to Henry Hub as a benchmark; and 2) independent verification of the price data reported to publishers. The report concludes that California prices did not correlate highly to Henry Hub during the refund period, failing the first prong of the test. It then finds that due to the publishers' "legitimate" confidentiality concerns, staff cannot independently validate the publishers' price data. On page 47, the independent validation test is explicitly tied to staff's ability to know "the source of the raw data."

While commending Platts' initiatives, the report states explicitly on page 36 that "price data must still be subject to independent validation by the commission before being used in a rate-setting proceeding." Since the California data do not meet staff's two-part test, staff recommends use of an alternative.

But the report seems internally inconsistent. Staff appears to contradict itself by recommending usage of producing basin prices from *Gas Daily* in the electricity refund calculation, which clearly is a rate-setting proceeding. The commission staff has not independently "validated" the producing basin data for the same reason cited for the California data – Platts has a legitimate right to protect the confidentiality of its source data. The staff report makes no attempt to explain why California data require validation

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by staff but producing basin data do not. Nor does it reconcile the flat statement on page 36 with use of the producing basin data in the recommended alternative.

VI. Use of EnronOnline data in price reporting

The staff report concludes that EnronOnline was a significant, "even dominant," source of gas price discovery. However, as Platts told the commission in its data response, Platts did not use prices from EOL in its price reporting.

If traders from whom Platts obtained prices were using EOL for price discovery, and if EOL had gained a dominant role in determining natural gas prices as a direct consequence of Congress' decision pursuant to the Commodity Futures Modernization Act of 2000 to exempt trading systems such as EOL from regulation, that is an issue for federal legislators and regulators to address. As discussed earlier, Platts believes that its prices represent a valid reflection of the market and that whether the market was manipulated or dominated by a specific player is a separate issue, and one that is outside the control of Platts or any other publisher.

The staff report notes that the *Gas Daily* index price for Southern California for October 2000 to July 2001 closely tracked the EOL daily price and concludes that "this is consistent with reports that EOL was a prominent source of price information for the published Western natural gas price data during 2000 and 2001." Platts finds that correlation unremarkable; no one questions that Enron – the largest gas marketer by far prior to its bankruptcy – was a major player in the gas market and that it executed much of its business via EOL. Platts' objective is to reflect the marketplace. If the *Gas Daily* price had *not* tracked the EOL price, might staff have then concluded that *Gas Daily* was inaccurate because EOL was a major market presence and reflected market prices?

The report devotes significant attention to trading on a specific day, Jan. 31, when 174 of 227 trades on EOL for next-day trades at Topock were with a single counterparty. It notes that the price on EOL rose from $11.30/MMBtu to $15.00/MMBtu, with an average price of $13.67/MMBtu. On that day, the *Gas Daily* absolute range for SoCal Gas trading was $11.10 to $16.05/MMBtu, with a common midpoint of $13.745/MMBtu. Enron's trading with the sole counterparty represented more than one-fourth of total volumes reported for that day to *Gas Daily*, the report notes. Staff says it is "continuing to investigate the trading behavior on this and other days with apparent anomalous trading patterns."

Platts, of course, lacked access to the detailed EOL trading information that staff is now analyzing as part of its investigation. However, it submits that regardless of Enron's trading pattern that day, reported SoCal Gas prices were not out of sync with the market. *Gas Daily*'s SoCal Gas midpoint reported on Jan. 31 for Feb. 1 flow, $13.745/MMBtu, was a 26% increase from the Jan. 30 midpoint of $10.88/MMBtu. However, the Jan. 30 price was unusually low. The average for the five business days prior to Jan. 30 was $14.76/MMBtu; the average for the five business days after Jan. 31 was $14.02/MMBtu.

In addition, prices rose significantly in Jan. 31 trading for Feb. 1 delivery at other California points in line with the SoCal Gas increase. The *Gas Daily* midpoint for deliveries to PG&E climbed from $10.50/MMBtu on Jan. 30 to $12.79/MMBtu on Jan. 31, or 22%. The midpoint for Malin rose from $8.33/MMBtu on Jan. 30 to $10.535/MMBtu on Jan. 31, or 26.5%. And the midpoint for PG&E citygate deliveries increased from $9.84/MMBtu on Jan. 30 to $13.925/MMBtu on Jan. 31, a 41.5% jump.

Regardless of what trading Enron conducted that day, there were market reasons for heavy and volatile gas trading on Jan. 31. For instance, PG&E instituted an operational flow order with a 2% tolerance and $5/Dt penalty, and market sources speculated that SoCal Gas might soon institute a 90% balancing mandate after withdrawing another 1 Bcf out of already depleted storage. The staff report does not address whether these or any other market factors may have contributed to the price increase seen in EOL trading.

VII. Wash trading

As an initial point, Platts notes that its news reports in May 2002 on electricity trading were the first to uncover wash trades in the energy business. Platts has been in the forefront in reporting on this topic.

The staff report concludes that "wash trading may have an adverse effect on reported price data." Yet it also states that no company admitted to engaging in gas wash trading, although eight companies gave answers other than "admit or deny." The only apparent basis for the report's conjecture that wash trading may affect reported prices is "information indicating that Enron may have been involved in considerable electricity and natural gas round trips or wash sales."

"Because there is no way to validate data given to publishers," the report says, "the possibility of a detrimental effect on prices cannot be discounted." But the commission in fact took steps to validate data by asking all gas and electricity sellers in the Western market in May to disclose any wash trades and, if any were made, to state under oath whether those trades were reported to Platts and other publishers. To the best of Platts' knowledge, no company stated that it reported a gas wash trade to Platts and Platts remains unconvinced that gas wash trades influenced its assessments. Platts hopes that the final FERC report reflects that important information gleaned in the staff's investigation.

VIII. Canadian producing basin prices

Platts requests clarification of which producing basin prices would be used for Northern California under staff's recommendation for the electricity price mitigation proceeding. The report advises use of the "West Coast (Alberta) price" from *Gas Daily*. Platts does not report a price point with that description.

Gas Daily reports prices at Westcoast station 2, in British Columbia, and at Nova AECO-C, in Alberta. The analysis on pages 63-67 indicates that staff envisions use of both of those producing basin prices. However, the explanation of "how the substitute natural gas index would work" beginning on page 71 again uses the nomenclature "West Coast (Alberta) index." And footnote 84 cites Canadian supply transportation costs reflecting delivery on PG&E Gas Transmission-Northwest from the Canadian border to California. Westcoast delivers British Columbia gas to Northwest Pipeline at the international border, not Alberta gas to PG&E-Northwest.

IX. Conclusion

Platts published price assessments during the period in question using methodologies that were widely understood and widely used. The methodologies have been subject for years to the scrutiny of market players, regulators and exchanges. As the staff report recognizes, pricing data were obtained from sources during the period in question on a confidential basis. As a publisher, Platts enjoys the protections afforded under the First Amendment and takes seriously its obligation to honor its confidentiality agreements with its sources. Platts also takes seriously its role as an independent source of insight on commodity markets and continually refines its price reporting methodologies to assure they reflect markets as accurately as possible.

Platts appreciates this opportunity to respond to the conclusions in the FERC staff report and trusts that the comments made here will be reflected in the final staff report to be issued in Docket No. PA02-2.

Respectfully submitted,

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